

FINANCIAL INFORMATION FORUM

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January 17, 2013

Electronic Delivery

Pamela Lew
CC:PA:LPD:PR (REG-102988-11)
Room 5203
Internal Revenue Service
P.O. Box 7604, Ben Franklin Station,
Washington, DC 20044

Re: Basis Reporting by Securities Brokers and Basis Determination for Debt Instruments and Options
[REG-102988-11]

Dear Ms. Lew,

The Financial Information Forum (FIF)¹ would like to submit recommendations for basis reporting by securities brokers and vendors for options. The FIF Cost Basis Working Group submitted comments² in 2012 outlining critical issues for reporting of basis information covering debt instruments and options and requested additional time for implementation. FIF appreciates the IRS delaying the effective date on the reporting for debt instruments and options which provides the industry with additional time to implement changes to various tax systems. However, the absence of Final Regulations leaves certain rules open for interpretation and leaves the industry in a discommodious situation of implementing rules that are vastly different from the debt reporting systems that currently exist and which took multiple years and extensive funding to implement. Additionally, there are substantial changes for options basis reporting required by the current effective date of January 1, 2014 which demands a comprehensive analysis of broker dealer and vendor systems followed by the development, testing and deployment of new changes. It is also important to note the same resources are simultaneously working on additional tax initiatives including FATCA, State Backup Withholding, IRS Distribution Withholding, General Annual Tax Projects, the French Transaction Tax and additional international transaction taxes coming to the forefront.

¹ FIF (www.fif.com) was formed in 1996 to provide a centralized source of information on the implementation issues that impact the financial technology industry across the order lifecycle. Our [participants](#) include trading and back office service bureaus, broker-dealers, market data vendors and exchanges. Through topic-oriented working groups, FIF participants focus on critical issues and productive solutions to technology developments, regulatory initiatives, and other industry changes.

² See FIF Comment Letters on REG-102988-11, dated [January 27, 2012](#), [February 23, 2012](#) and [October 17, 2012](#)

We believe the following recommendations for options basis reporting will facilitate industry implementation of these new requirements and request the IRS to consider these in the final regulations.

1. FIF requests the IRS treat 1256 Options as non-covered to minimize taxpayer confusion and reduce conflicting reporting resulting from brokers following rules specific for general Options and 1256 Options subject to mark to market reporting.
2. FIF requests clarity and consistency on reporting requirements for the following:
 - a. Backup withholding
 - b. Section 305 and 307 Provisions
3. FIF recommends the IRS relieve brokers from tracking compensatory options for 1099 reporting and transfer purposes which would create unnecessary recordkeeping challenges for an activity that is considerably low in volume, will be expensive to implement and doesn't provide substantial value to the taxpayer and IRS.

Special Handling for 1256 Options

Options subject to Section 1256 make up a small percentage of overall options transactions. Under the proposed regulations, a broker dealer would be required to report Section 1256 Options under the general rules for options reporting. These don't, however, include rules specific to Section 1256 Options such as the requirement to mark to market on the last day of the taxable year and mark to market on physical settlement. Since taxpayers must already comply with Section 1256 rules, requiring a broker dealer to report basis for Section 1256 Options following the general option rules will be inconsistent with the mark to market rules and result in unnecessary reconciliations by the taxpayer. FIF would like to reiterate its earlier position³ and agrees with SIFMA's statement in their Aug 27, 2012 response (SIFMA's recommendations)⁴ concerning the potential for taxpayer confusion resulting from inconsistent reporting and requests the IRS treat 1256 Options as non-covered in the final regulations. In general, we believe that it will be easier for brokers to identify options subject to Section 1256 reporting rules and exclude them from reporting than to explain to customers why the broker is reporting something different than what they are required to report. If the IRS does treat Section 1256 Options as covered, FIF requests additional time, guidance and specific rules for reporting Section 1256 Options in a way that will be consistent with taxpayer reporting.

³ See FIF [Letter to the IRS](#) dated February 23, 2012 on Proposed Cost Basis Regulations for Debt and Options

⁴ See [SIFMA's Letter to IRS](#) dated August 27, 2012

Consistent Options Reporting

FIF requests that the IRS clarify reporting requirements for proceeds on the disposition of an option that is not physically settled. In such a scenario, the proposed regulations state that a broker must increase gross proceeds for all payments received and decrease gross proceeds for all payments paid on the option. If the amount paid on an option is less than the amount received, this could result in the reporting of negative gross proceeds. The following example in the proposed regulations⁵ illustrates the rules in this paragraph (m):

Example. (i) On January 15, 2013, C, an individual, sells a 2-year exchange-traded option on 100 shares of Company X through Broker D. C receives proceeds of \$100 for the sale of the option and pays no commission. On December 16, 2013, C pays \$110 to close out the option.

(ii) D is required to report information about the closing transaction because the option is on a covered security as described in paragraph (a)(15)(i)(D) of this section and was part of a closing transaction described in paragraph (a)(8) of this section. D will report as gross proceeds the net of the \$100 received as option premium minus the \$110 C paid to close out the option, for a total of -\$10. Under the rules of section 1234(b)(1) and paragraph (d)(2) of this section, D will also report that the loss on the closing transaction is a short-term loss.

Proposed Regulations 1099B Reporting

1099B Reporting

Proceeds	Cost	Holding Period
-\$10.00	110.00	Short Term

FIF/SIFMA Recommendation

Proceeds	Cost	Holding Period
\$100.00	\$110.00	Short Term

In effect, this amounts to reporting the actual gain or loss on the disposition of the option as opposed to reporting actual proceeds as is required for all other securities. In order to avoid taxpayer confusion and

⁵ See [proposed IRS regulations on Basis Reporting for Debt and Options](#)

minimize complexities, FIF requests that the IRS clarify reporting of costs and proceeds in the above scenario and make it consistent with the reporting of other covered securities.

Backup withholding

FIF agrees with SIFMA's recommendations on giving the broker dealers a choice to withhold on the total amount from a sale or reported gross proceeds upon the closing of an options position. This choice exists today when closing a short sale of stock and gives the broker flexibility to administer backup withholding in a well-structured manner.

Section 305 and 307 Provisions

The proposed regulations include the issuance of a warrant or a stock right to an option as part of a corporate action. These "rights" must also have their basis determined by broker dealers following the provisions of Section 305 and 307 which govern the distribution of rights as nontaxable events and the allocation of the adjusted basis of stock with respect to which "rights" are allocated between the underlying stock and the rights in proportion to the fair market values on the date of distribution. The basis of the rights is zero if the fair market value at the time of distribution is less than 15% of the fair market value of the underlying stock. FIF agrees with SIFMA's recommendations that final regulations should allow broker dealers to assume that rights are distributed in non-taxable events with no allocation of basis.

Compensatory Options

The Proposed Regulations indicate that the IRS is "exploring the possibility of adding an indicator on the Form 1099-B to denote a sale of compensation-related stock" and includes a requirement that transfer statements include "Whether the security was received in connection with the exercise of a compensatory option or the vesting or exercise of any other equity based compensation arrangement and whether basis has been adjusted for any compensation income." FIF would like to point out that this additional information (i.e. a particular tax lot or lots was acquired through the exercise of compensatory options) is not captured or tracked by brokers today and would be very costly to implement across the industry.

We understand that upon the sale of shares acquired through a compensation-related option, the taxpayer will need to reconcile the basis of the shares acquired through the compensation-related plan

reported by the broker with the compensation and taxes withheld (if any) reported by the employer. However, in general, brokers have no knowledge of the details of these plans or the amounts of compensation or withholding. The employer is required to report the information required to support the reconciliation of the basis amount to the taxpayer concurrent with the distribution of shares. The broker's role in this process today is to receive the shares and cost from the administrator or the agent through a transfer statement and later report the basis of these shares when they are sold. FIF believes tracking compensatory options for 1099 reporting and transfer purposes would create unnecessary recordkeeping challenges since such options seldom transfer and transfer agents commonly exercise and transfer/deliver stock for these options. Since the volumes of these assets are minimal, we feel the information is of limited value to taxpayers and the IRS such that the cost of building the appropriate systems would far outweigh the value of the information. FIF therefore recommends that the IRS does not require that brokers track, transfer and report whether a security was received in connection with the exercise or vesting of a compensatory option or other equity based compensation arrangement and whether basis was adjusted for any compensatory income.

FIF looks forward to working with the IRS on addressing options and fixed income basis reporting issues and would like to reiterate the immediate need for Final Regulations to give the industry sufficient time for a successful implementation of this significant project. Please don't hesitate to contact us at fifinfo@fif.com or 212-422-8568 with any questions.

Regards,



Arsalan Shahid

Program Director, Financial Information Forum

On behalf of FIF Cost Basis Working Group